

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



February 13, 2003

Alternate to Agenda ID# 1481

TO: PARTIES OF RECORD IN APPLICATION # 02-06-019.

Enclosed is the Alternate Draft Decision of Commissioner Brown to the Draft Decision of Administrative Law Judge (ALJ) Barnett previously mailed to you.

When the Commission acts on the draft or alternate decision, it may adopt all or part of it as written, amend or modify it, or set aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Public Utilities Code Section 311(e) requires that an alternate to a draft decision be served on all parties, and be subject to public review and comment prior to a vote of the Commission. Rule 77.6(d) provides that comments on the alternate draft decision be filed at least seven days before the Commission meeting.

Please note that the alternate decision makes one substantive change to the ALJ's draft decision; Issue number 14 of the Final Arbitrator's Report is revised to conform to prior Commission decisions regarding VNXX traffic.

Comments on the alternate decision must be filed and served Thursday, February 20, 2003. Reply comments must be filed and served Tuesday, February 25, 2003.

Pursuant to Rule 77.3 comments shall not exceed 15 pages. Finally, comments must be served separately on the ALJ and the assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious method of service.

/s/ ANGELA K. MINKIN
Angela K. Minkin
Chief Administrative Law Judge

CAB:vfw

Attachment

Decision **ALTERNATE DRAFT DECISION OF COMMISSIONER BROWN**
(Mailed 2/13/03)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas And Electric Company
for Authority to Increase Electric And Gas
Revenue Requirements To Reflect An Attrition
Revenue Adjustment For The Year 2002.
(U 39 M)

Application 02-06-019
(Filed June 11, 2002)

OPINION

Summary

Pacific Gas and Electric Company (PG&E) requests authority to increase its base revenue requirements for electric and gas distribution, customer services, and Humboldt Nuclear SAFSTOR activities to reflect an attrition revenue adjustment (ARA) for the year 2002. PG&E requests that these revenue requirement increases be effective as of April 22, 2002.

PG&E proposes a total base revenue requirement increase of \$96.326 million, comprised of \$76.707 million for electric distribution, \$19.48 million for gas distribution, and \$0.139 million for nuclear decommissioning for Humboldt Power Plan Nuclear SAFSTOR expense. PG&E says that these increases are necessary to reflect its rate base growth due to an estimated \$1 billion in planned capital additions for 2002, as well as expense growth in such areas as wages and salaries and the costs of goods and services.

Of the total requested increase, approximately \$64 million is associated with PG&E's planned capital additions.

The Office of Ratepayer Advocates (ORA) protests PG&E's request. It argues that PG&E's attrition increases should be denied on policy grounds, should be denied because PG&E failed to file a timely application for a general rate case increase, and should be denied because a complete review of PG&E's revenues and expenses is needed before granting a rate increase.

Both PG&E and ORA agree that this proceeding can be decided without the need for a public hearing. At the prehearing conference held on September 26, 2002, the matter was submitted on the pleadings, and PG&E's Exhibits 1 and 2.

We approve the attrition increase request in part. In our review of PG&E's recent rate cases it is apparent that PG&E has not had a full review of its costs since its 1999 general rate case decision (D.) 00-02-046. The expense recorded numbers are too stale and the escalation rates too uncertain to sustain a finding increasing rates by \$96.3 million to meet 2002 costs and rate base. We approve \$73.8 million in capital increases related to growth.

PG&E's Position

PG&E states that it expects to connect approximately 61,000 new electric and 40,000 new gas customers in 2002, and that it needs to spend capital to add gas and electric distribution capacity to serve increasing loads and to maintain and replace electric and gas distribution equipment. It expects to invest \$1 billion in 2002. Without an increase in authorized revenue to pay for these investments, PG&E argues that its ability to continue to finance this level of capital additions, year to year, will be adversely affected. Absent the revenue

requirement increases requested, PG&E says that it will earn significantly less than its authorized rate of return.

The ARA methodology PG&E proposes for deriving escalation rates is consistent with the 2001 ARA final decision (D.) 02-02-043; that is, PG&E applied one year of escalation (i.e. from 2001 to 2002) to previously adopted electric and gas operating expense levels. For electric operating expense, PG&E escalated the level expenses adopted in the 2001 ARA final decision; for gas operating expense, the level adopted in PG&E's 1999 GRC decision. (D.00-02-046.)

For rate base and capital-related items, PG&E derived both gas and electric 2002 rate base using the seven-year average of plant additions (for years 1994-2000 in constant dollars). For electric distribution, PG&E escalated the seven-year average of plant additions to 2002-year dollars and used the resulting number to derive the rate base growth over the rate base adopted in the 2001 ARA final decision. For gas distribution, PG&E escalated the seven-year average of plant additions to 2002-year dollars and used the resulting number to derive the rate base growth over the recorded 2001 rate base.

For its electric distribution results of operations for estimated 2002, at current rates PG&E predicts an 8.56% rate of return; at proposed rates a 9.12% rate of return. The electric rate increase requested is \$76,707,000. PG&E's authorized electric distribution rate of return is 9.12%, per D.00-06-040. See Table 1.

PACIFIC GAS AND ELECTRIC COMPANY
2002 ATTRITION APPLICATION
TABLE 1
ELECTRIC DISTRIBUTION (CPUC JURISDICTION)
RESULTS OF OPERATIONS
(Thousands of Dollars)

Line No.	Description	2001 Attrition Decision 02-02-043	2002		Line No.
			Present Rates	Proposed Rates	
		(A)	(B)	(C)	
REVENUE:					
1	General Rate Case Revenue	2,239,676	2,239,676	2,239,676	1
2	Increase	0	0	76,707	2
3	General Rate Case Revenue	2,239,676	2,239,676	2,316,383	3
OPERATING EXPENSES:					
4	Energy Costs	0	0	0	4
5	Other Production	0	0	0	5
6					6
7	Transmission	690	708	708	7
8	Distribution	397,629	408,366	408,366	8
9	Customer Accounts	186,526	192,156	192,156	9
10	Uncollectibles	7,533	7,533	7,791	10
11	Customer Services	0	0	0	11
12	Administrative and General	186,726	191,190	191,190	12
13	Franchise Requirements	13,850	13,850	14,324	13
14	Project Amortization	0	0	0	14
15	Wage Change Impacts	0	0	0	15
16	Other Price Change Impacts	0	0	0	16
17	Other Adjustments	0	0	0	17
18	Subtotal Expenses:	792,953	813,803	814,535	18
TAXES:					
19					19
20	Property	83,417	87,039	87,039	20
21	Payroll	32,194	32,194	32,194	21
22	Business	335	335	335	22
23	Other	0	0	0	23
24	State Corporation Franchise	36,901	31,641	38,357	24
25	Federal Income	211,938	192,529	219,120	25
26	Total Taxes	364,784	343,737	377,044	26
27	Depreciation	416,891	434,919	434,919	27
28	Fossil Decommissioning	0	0	0	28
29	Nuclear Decommissioning	0	0	0	29
30	Total Operating Expenses	1,574,629	1,592,459	1,626,499	30
31	Net for Return	665,047	647,217	689,884	31
32	Rate Base	7,292,186	7,563,858	7,563,858	32
RATE OF RETURN:					
33	On Rate Base	9.12%	8.56%	9.12%	33
34	On Equity	11.23%	10.04%	11.22%	34

For its gas distribution results of operations for estimated 2002, at current rates PG&E predicts an 8.62% rate of return; at proposed rates a 9.12% rate of return. The electric rate increase requested is \$19,480,000. PG&E's authorized gas distribution rate of return is 9.12%, per D.00-06-040. See Table 2.

PACIFIC GAS AND ELECTRIC COMPANY
2002 ATTRITION APPLICATION
TABLE 2
TOTAL GAS DISTRIBUTION
RESULTS OF OPERATIONS
(Thousands of Dollars)

Line No.	Description	1999 Authorized At 2000 Cost Of Capital	Year 2000 At Present Rates With Recorded Rate Base	Year 2001 At Present Rates With Recorded Rate Base	Attrition Year 2002		Line No.
					At Present Rates	At Proposed Rates	
		(A)	(B)	(C)	(D)	(E)	
REVENUE:							
1	General Rate Case Revenue	894,394	894,394	894,394	894,394	894,394	1
2	Increase	0	0	(0)	0	19,480	2
3	General Rate Case Revenue	894,394	894,394	894,394	894,394	913,874	3
OPERATING EXPENSES:							
4	Energy Costs	0	0	0	0	0	4
5	Other Production	3,277	3,277	3,277	3,373	3,373	5
6	Storage	24	24	24	24	24	6
7	Transmission	0	0	0	0	0	7
8	Distribution	139,288	139,288	139,288	143,373	143,373	8
9	Customer Accounts	140,827	140,827	140,827	145,072	145,072	9
10	Uncollectibles	3,013	3,013	3,013	3,013	3,079	10
11	Demand-Side Management	0	0	0	0	0	11
12	Administrative and General	98,525	98,525	98,525	101,053	101,053	12
13	Franchise Requirements	13,170	13,170	13,170	13,170	13,457	13
14	Project Amortization	0	0	0	0	0	14
15	Wage Change Impacts	0	0	0	0	0	15
16	Other Price Change Impacts	0	0	0	0	0	16
17	Other Adjustments	0	0	0	0	0	17
18	Subtotal Expenses:	398,124	398,124	398,124	409,079	409,432	18
TAXES:							
19							19
20	Property	23,540	24,584	25,444	26,428	26,428	20
21	Payroll	17,414	17,414	17,414	17,414	17,414	21
22	Business	132	132	132	132	132	22
23	Other	0	0	0	0	0	23
24	State Corporation Franchise	12,222	10,687	9,885	7,908	9,599	24
25	Federal Income	31,913	30,694	28,586	21,634	28,328	25
26	Total Taxes	85,221	83,511	81,461	73,516	81,901	26
27	Depreciation	211,306	213,255	220,418	228,555	228,555	27
28	Fossil Decommissioning	0	0	0	0	0	28
29	Nuclear Decommissioning	0	0	0	0	0	29
30	Total Operating Expenses	694,652	694,890	700,004	711,150	719,888	30
31	Net for Return	199,742	199,504	194,390	183,244	193,986	31
32	Rate Base	2,189,719	2,119,751	2,108,645	2,126,620	2,126,620	32
RATE OF RETURN:							
33	On Rate Base	9.12%	9.41%	9.22%	8.62%	9.12%	33
34	On Equity	11.22%	11.82%	11.42%	10.17%	11.22%	34

ORA'S Position

ORA states that PG&E is not automatically entitled to attrition increases between rate cases.

The attrition mechanism is not an entitlement. Nor is it a method of insulating the company from the economic pressures which all businesses experience...Neither the Constitution nor case law has ever required automatic rates increases between general rate case applications. (D.93-12-043, 52 CPUC 2d 471,492.)

In its test year (TY) 1999 general rate case decision, the Commission authorized attrition for 2001, but denied it for 2000. On February 21, 2002, the Commission issued D.02-02-043 granting PG&E a 2001 attrition increase of approximately \$151 million. PG&E's claim that it is entitled to an attrition increase for 2002 is belied by both the substantial magnitude of the \$151 million attrition increase granted by D.02-02-043 and by its ability to manage its system for many years between general rate cases without any attrition increases.

Further, argues ORA, PG&E should not be rewarded with an attrition increase because of a delay of its own making. It was PG&E that requested a delay in the filing of its 2002 general rate case. Therefore, the need for a 2003 general rate case was the direct result of PG&E's election to delay the filing of its TY 2002 general rate case. Having voluntarily delayed a complete review of its cost structure, it should not now be rewarded with yet another attrition increase.

ORA's principal contention is that PG&E's cost structure should be fully reviewed in detail before any further rate increases are granted. In directing the filing of a 2003 TY general rate case, the Commission said:

Developments following the deregulation of the wholesale electricity market have changed utility operations and current rates may no longer reflect PG&E's cost of service. For this reason, it is necessary to review PG&E's revenue

requirement to determine if PG&E's rates are just and reasonable. (D.01-10-059, *slip op.*, p.4.)

ORA believes that any further attrition increase contradicts the Commission's observation regarding the need to examine the reasonableness of PG&E's current costs and rates.

Discussion

In our review of PG&E's recent rate cases it is apparent that PG&E has not had a full review of its costs since its 1999 general rate case decision D.00-02-046. In that decision, the base year used for recorded costs was primarily 1996, plus some from 1997. (D.00-02-046, *slip op.* 154-160.) In our 2001 attrition proceeding (Application (A.) 00-07-043), we calculated the attrition increase based on 1999 recorded rate base and expense levels adopted in D.00-02-046, plus approximately 3% inflation costs. (D.02-02-043, pp 18-19.)

In D.02-02-043, because of PG&E's unprecedented financial problems, we were uncertain about the actual rate base of PG&E in 2001.

We said:

"... 2001 was an extraordinary year, and PG&E faced unprecedented financial problems. It is reasonable to conclude that PG&E's financial woes would impact PG&E's capital spending. PG&E has informed the Commission of efforts to reduce costs such as scaling back of distribution undergrounding work.

"The record before us is insufficient to determine if PG&E's financial problems resulted in extraordinary reductions in PG&E's capital spending in 2001, but PG&E should recover its reasonably incurred costs. Therefore, while we approve the increase in capital-related costs stated above, we will make this increase subject to revision downward should PG&E's actual 2001 capital costs be less than the assumed amount underlying our increase. This will enable PG&E to recover its costs, but

protect ratepayers should we determine PG&E's capital spending was reduced in 2001." (*Id.* at pp 16-17.)

As of this date we have not reviewed PG&E's actual 2001 capital costs.

In D.02-04-056, we considered PG&E's motion for an order ensuring that if, at a later date, the Commission approves an ARA for 2002, the adjustment would be made effective as of the date of the order granting the motion. We granted that motion in D.02-04-056, with an April 22, 2002 effective date.

We said:

1. The *Motion of Pacific Gas & Electric Company (PG&E) for Interim Decision Regarding 2002 Attrition* is granted as set forth below.
2. In the event that the Commission authorizes an ARA for PG&E for 2002, such authorization may be made effective as of the effective date of this Interim Order or such later date as may be determined by the Commission.
(D.02-04-056, at p 8.)

In the body of the decision, we made abundantly clear that we were not assuring PG&E that an ARA would be granted.

We said:

We need to allow adequate time for full and fair consideration of whether to approve an ARA for 2002, and if so the parameters and magnitude of such an adjustment.

* * *

We emphasize that we are simply preserving our option to authorize an ARA that could be made effective today. We reserve our right to deny an ARA for 2002 after further consideration. Nothing in today's decision assures PG&E an ARA for 2002. (D.02-04-056 at p. 3, emphasis added.)

We are not willing to simply deny PG&E's ARA request. While discretionary in this instance, an ARA is intended to compensate the utility for predictable increases in expenses and capital between rate cases. We granted an ARA in 2001 for this reason. Here, we need to evaluate whether PG&E's request is appropriate in more detail. While ORA did not specifically address the elements of PG&E's request, its protest contains some valid points to consider.

ORA claims the recorded numbers are too stale and the escalation rates too uncertain to sustain a finding regarding the need to increase PG&E's rates for expense changes. There have been great changes in the economy of California and the United States in the six years since PG&E's last recorded costs were placed on a record before us. There have been even greater changes in the economic status of PG&E. We agree with ORA that we cannot assume that merely escalating 1996 and 1997 costs (at escalation rates that may have no relation to current interest rates) will result in an accurate rendering of PG&E's expenses in 2002. The gap between recorded and estimated expenses tends to increase over time due to the inherent variability in actual expenses. PG&E's management has significant discretion in managing expenses. The longer the period between rate cases, the greater the likelihood that projected expenses will vary from actual needs. It requires a general rate case to re-establish reasonable expense levels.

Our analysis is somewhat different for rate base. Rate base does not vary to the same degree as expenses. PG&E's rate base escalation is based on seven-year average of actual rate base increases, reflecting a longer term pattern that smoothes out most variability.

Given that an ARA for 2002 is not an entitlement for PG&E, it is reasonable to focus in on the portion of PG&E's request which is most needed. It is not at all

clear that an escalation in expenses is needed at this time, but it is appropriate to provide an escalation for the more predictable changes in rate base.

Therefore, we will approve PG&E's request for a \$73.8 million ARA adjustment for capital, which consists of \$63.5 million on the electric side (See Table 3) and \$10.3 million on the gas side (See Table 4)

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Pacific Gas and Electric Company
2002 Attrition
Table 3
Total Electric Distribution (CPUC Jurisdiction)
Results of Operations
(Thousands of Dollars)

Line No.	Description	2001 Attrition Decision	2002		Line No.
			PG&E Application	Authorized Rates	
REVENUE:					
1	General Rate Case Revenue	2,239,676	2,239,676	2,239,676	1
2	Increase	<u>0</u>	<u>0</u>	<u>63,500</u>	2
3	General Rate Case Revenue	2,239,676	2,239,676	2,303,176	3
OPERATING EXPENSES:					
4	Energy Costs	0	0	0	4
5	Other Production	0	0	0	5
6					6
7	Transmission	690	708	690	7
8	Distribution	397,629	408,366	397,629	8
9	Customer Accounts	186,526	192,156	186,526	9
10	Uncollectibles	7,533	7,533	7,533	10
11	Customer Services	0	0	0	11
12	Administrative and General	186,729	191,190	186,729	12
13	Franchise Requirements	13,850	13,850	13,850	13
14	Project Amortization	0	0	0	14
15	Wage Change Impacts	0	0	0	15
16	Other Price Change Impacts	0	0	0	16
17	Other Adjustments	<u>0</u>	<u>0</u>	<u>0</u>	17
18	Subtotal Expenses	792,957	813,803	792,957	18
TAXES					
19					19
20	Property	83,417	87,039	87,039	20
21	Payroll	32,194	32,194	32,194	21
22	Business	335	335	335	22
23	Other	0	0	0	23
24	State Corporation Franchise	36,901	31,641	40,601	24
25	Federal Income	<u>211,938</u>	<u>192,529</u>	<u>225,290</u>	25
26	Total Taxes	364,785	343,738	385,459	26
27	Depreciation	416,891	434,919	434,919	27
28	Fossil Decommissioning	0	0	0	28
29	Nuclear Decommissioning	<u>0</u>	<u>0</u>	<u>0</u>	29
30	Total Operating Expenses	1,574,633	1,592,460	1,613,335	30
31	Net For Return	665,047	647,216	689,841	31
32	Rate Base	7,292,186	7,563,858	7,563,858	32
RATE OF RETURN:					
33	On Rate Base	9.21%	8.56%	9.12%	33

Pacific Gas and Electric Company

2002 Attrition

Table 4

Total Gas Distribution

Results of Operations

(Thousands of Dollars)

Line No.	Description	1999 Authorized*	2002		Line No.
			PG&E Application	Authorized Rates	
REVENUE:					
1	General Rate Case Revenue	894,394	894,394	894,394	1
2	Increase	<u>0</u>	<u>0</u>	<u>10,300</u>	2
3	General Rate Case Revenue	894,394	894,394	904,694	3
OPERATING EXPENSES:					
4	Energy Costs	0	0	0	4
5	Other Production	3,277	3,373	3,277	5
6	Storage	24	24	24	6
7	Transmission	0	0	0	7
8	Distribution	139,288	143,373	139,288	8
9	Customer Accounts	140,827	145,072	140,827	9
10	Uncollectibles	3,013	3,013	3,013	10
11	Demand-Side Management	0	0	0	11
12	Administrative and General	98,525	101,053	98,525	12
13	Franchise Requirements	13,170	13,170	13,170	13
14	Project Amortization	0	0	0	14
15	Wage Change Impacts	0	0	0	15
16	Other Price Change Impacts	0	0	0	16
17	Other Adjustments	<u>0</u>	<u>0</u>	<u>0</u>	17
18	Subtotal Expenses	398,124	409,078	398,124	18
TAXES					
19					19
20	Property	23,540	26,428	26,428	20
21	Payroll	17,414	17,414	17,414	21
22	Business	132	132	132	22
23	Other	0	0	0	23
24	State Corporation Franchise	12,222	7,908	11,352	24
25	Federal Income	<u>31,913</u>	<u>21,634</u>	<u>28,775</u>	25
26	Total Taxes	85,221	73,516	84,101	26
27	Depreciation	211,306	228,555	228,555	27
28	Fossil Decommissioning	0	0	0	28
29	Nuclear Decommissioning	<u>0</u>	<u>0</u>	<u>0</u>	29
30	Total Operating Expenses	694,651	711,149	710,780	30
31	Net For Return	199,743	183,245	193,914	31
32	Rate Base	2,189,719	2,126,620	2,126,620	32
RATE OF RETURN:					
33	On Rate Base	9.12%	8.62%	9.12%	33

* At 2000 cost of capital

Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g)(1) and Rule 77.7 of the Commission's Rules of Practice and Procedure. Comments were filed by ORA and PG&E. ORA supports the draft decision as written. PG&E asserts that the draft decision, by denying an attrition increase, is wrong. It gives three reasons.

- The draft decision's denial of attrition appears to be based on an erroneous understanding of Exhibit D to PG&E's application, which shows total company results of operations for 2001, as compared to PG&E's attrition request, which covers only its electric and gas distribution operations.
- The draft decision errs in concluding that the recorded numbers and escalation rates used in PG&E's attrition application are stale or uncertain.
- The draft decision errs in concluding that PG&E's current earnings do not warrant attrition relief.

The alternate decision of Commissioner Brown was mailed on February 13, 2002. The alternate decision considers PG&E's comments in reaching a different result, as discussed herein. Comments were filed on _____, and reply comments were filed on _____.

Assignment of Proceeding

Michael Peevey is the Assigned Commissioner and Robert Barnett is the assigned ALJ in this proceeding.

Findings of Fact

1. PG&E's recorded costs, other than rate base, have not been fully reviewed by this Commission since PG&E's 1999 general rate case which used 1996 as a base year, plus some costs from 1997.

2. It is too speculative to base an interim increase for expenses in 2002 on such stale numbers. However, the long-term trend associated with a rate base increase allows consideration of an attrition rate adjustment.

3. By its own estimate PG&E is currently earning a rate of return of 8.56% on its electric distribution system and 8.62% on its gas distribution system, compared to its authorized rate of return of 9.12% on both systems.

Conclusions of Law

1. PG&E's application to increase electric and gas rates in 2002 to reflect an attrition revenue adjustment should be granted in part.

2. It is not reasonable to assume that escalating 1996 and 1997 costs relating to expenses will result in an accurate rendering of PG&E's costs relating to expenses in 2002.

3. It is reasonable to grant an attrition increase of \$63.5 million for electric rate base and \$10.3 million for gas rate base.

4. This order should be effective today to provide certainty to PG&E.

O R D E R

IT IS ORDERED that:

1. The relief requested in this application is granted in part.
2. This proceeding is closed.

This order is effective today.

Dated _____, at San Francisco, California

CERTIFICATE OF SERVICE

I certify that I have by mail this day served a true copy of the original attached Draft Decision of Commissioner Brown on all parties of record in this proceeding or their attorneys of record.

Dated February 13, 2003, at San Francisco, California.

/s/ VANA WHITE

Vana White

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.